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SUBJECT: UPDATE: PHILIPPINES AND GLOBAL FINANCIAL CRISIS

REFS: A) State 107872, B) Manila 2174

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¶1. (SBU) Summary: During October 6-10, the Philippine stock market index dropped by more than 18% to its weakest level in more than 27 months and the peso hit seventeen-month lows, yet banks maintained adequate foreign exchange and peso liquidity. The stock index then rose by 8.4% on October 13-14. President Arroyo has called for an ASEAN+3 summit to coordinate regional responses to the crisis (septel). The Ambassador and Mission members conveyed Ref A points on USG actions at public and private meetings. Potential Philippine exposure to distressed financial institutions remains at less than 2% of Philippine banking resources. The Philippine government does not allow insurance companies to invest in structured products. The Philippines does not have a sovereign wealth fund and international reserves remain adequate and conservatively invested. The economy is in a stronger position to weather the global financial storm due to fiscal and banking reforms and debt management initiatives, and the financial crisis may be providing greater urgency to pursue unfinished reforms. End Summary.

EXPOSURE TO TROUBLED INSTITUTIONS LIMITED

¶2. (U) In a meeting with econoffs on October 10, senior Central Bank officials reiterated that Philippine banks have limited direct exposure to troubled U.S. and European financial institutions. They estimated total potential exposure at about 1.8% of banking system assets ($1.8 billion), including about $800 million of exposures to institutions that are being bailed out by their respective governments or which have been sold to new private owners. The affected Philippine banks are well-capitalized; do not have solvency issues; and are not experiencing heavy withdrawals. Central Bank officials noted that interbank lending has slowed in recent weeks as banks defensively conserve liquidity. However, liquidity remains adequate and banks have not required emergency assistance to-date.

SOME TIGHTNESS, BUT NO SCARCITY OF FOREIGN EXCHANGE

¶3. (SBU) There is no scarcity of foreign exchange, according to the Central Bank officials. They shared that a number of local banks have begun withdrawing overseas placements/investments to bring back into the country due to global uncertainties. There is some tightness in the interbank foreign exchange market because of individual banks? desire to hold on to, or build-up, foreign exchange holdings due to the current global jitters. The Central Bank has injected foreign exchange liquidity in the market as needed and is set to launch a $-denominated repurchase facility (on $-denominated Republic of the Philippines bonds) as a temporary contingency measure. Pre-Christmas Overseas Filipino Worker (OFW) remittances are expected to keep international reserves stable and

to help temper pressure on the peso. OFW remittances are up 18% over 2007 and on track to exceed $16 billion by yearend.

INTERNATIONAL RESERVES SECURE

¶4. (U) Central Bank officials estimated gross international reserves at $36.7 billion as of end-September -- little changed from the $36.9 billion record high posted in July, adequate for close to six months worth of merchandise and service imports, and equivalent to 2.6 times foreign debt obligations falling due in the next twelve months. An estimated 87% of the reserves are held in ?foreign investments? and about 11% in gold. The ?foreign investments? are held in investment-grade (mostly Triple A) sovereign bonds and securities issued by multilateral agencies (i.e., the World Bank and Asian Development Bank). The Philippines does not have a Sovereign Wealth Fund.

ROOM FOR MONETARY EASING?

¶5. (SBU) After raising rates by a cumulative 100 basis points from June to August, the Philippine Monetary Board (the Central Bank?s highest policymaking body) kept repurchase and reverse repurchase rates steady at 8% and 6%, respectively, during its October 6 meeting. Some Central Bank officials have hinted that the recent, concerted action by foreign central banks to cut rates, as well as easing pressures on food and oil prices, may give the Monetary Board some flexibility to consider monetary easing during its next regular meeting in November. The Monetary Board does not plan to hold an off-cycle review prior to its regular meeting next month.

INSURANCE SECTOR, STATE PENSION FUNDS HOLDING UP

¶6. (U) AIG has officially announced that Philamlife -- its local subsidiary and the largest player in the Philippine insurance market -- is for sale. The Philamlife Group (which also has interests in a savings bank, in the pre-need business, and in financial asset management) has an estimated $3.8 billion in total assets and $1 billion net worth. Over ten potential bidders have reportedly expressed interest to acquire the company, which is considered as one of the Philippines? most profitable and venerable institutions. It has been business as usual for Philamlife pending the company?s sale.

¶7. (U) Senior officials from the Philippine Insurance Commission recently noted that the insurance sector?s investments are closely regulated. No insurance company is exposed to the troubled institutions in the United States and Europe. Less than 10% of the industry?s funds are invested in foreign-denominated assets, over 90% of which are in Philippine sovereign bonds. The Commission does not allow investments in structured products.

¶8. (U) Officials from the Social Security System (SSS, the mandatory pension fund for private sector employees) reiterated during a recent hearing in the Philippine Senate that it has no overseas investments. Officials from the Government Service Insurance System (the mandatory pension fund for public sector personnel) stated in separate media interviews that investments are safe. Legislators are pressing for more detailed disclosure of GSIS?s $1 billion Global Investment Fund (equivalent to about 12% of the pension fund?s loan and investment portfolio).

EMBASSY OUTREACH

¶9. (SBU) The Ambassador used a speech to an economic roundtable October 10 and a radio interview October 12 to convey messages on USG actions (Ref A). Mission members have kept the focus on the serious USG response and international coordination, despite some early carping from European counterparts and some Philippine pundits.

CHALLENGING TIMES AHEAD

¶10. (SBU) While direct exposure to problematic investments and financial institutions is limited, the impact of the global

financial crisis on economic growth, poverty alleviation, local and overseas employment, remittances, credit availability, and overall investment prospects is a concern. In a statement on September 30, the Philippine government vowed to accelerate infrastructure and agricultural spending, fast-track financial sector reform reforms, improve revenue generation through improved tax administration and legislative measures, and reduce regulatory and administrative bottlenecks to boost competitiveness.

COMMENT

¶11. (SBU) The financial crisis appears to be providing a greater sense of urgency to pursue unfinished reforms -- several supported by USG grants and technical assistance -- with greater vigor. Recent initiatives in the Philippine Congress include a proposed review of foreign ownership limitations in the Philippine Constitution, which members of the government?s economic team vowed to support. President Arroyo?s call for an ASEAN+3 summit shows commendable regional initiative in confronting a global problem. End Comment.

Kenney